

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of)	
)	
Developing a Unified Intercarrier)	CC Docket No. 01-92
Compensation Regime)	

**INITIAL COMMENTS OF
MINNESOTA INDEPENDENT COALITION**

Richard J. Johnson
M. Cecilia Ray
Moss & Barnett
4800 Wells Fargo Center
90 South 7th Street
Minneapolis, MN 55402
612.347.0300

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SUMMARY

It is premature to begin a process aimed at a sweeping overhaul of inter-carrier compensation that would include small Local Exchange Carriers (“small LECs”). Instead, because of the very different characteristics of small LECs and price cap LECs and the very different impacts of bill-and-keep on their respective local rates, the Commission should exclude small LECs from any current investigation of the feasibility of a unified bill-and-keep regime. The Commission has taken such an approach in considering both universal service and access charge reform, and the same approach would also be appropriate here. Several factors support this approach.

First, the impact of a bill-and-keep regime on local ratepayers of small LECs, and on state and federal universal service funding requirements, would be enormous and far more significant than the impact on price cap LECs. Small LECs obtain a far greater portion of their total revenues from interstate and intrastate access revenues than do price cap LECs, and small LECs would be required to replace access revenues either by increases in local rates or increases in universal service support. The practical impacts will raise additional difficult issues for small LECs that require separate consideration.

Second, any investigation of a such a radical replacement for intercarrier compensation will impose substantial administrative costs, and will cause added uncertainty that will chill investment decisions for small LECs, adversely affecting quality of service and deployment of advanced services. These adverse consequences should not be incurred unless and until both the legal authority to impose bill-and-keep is clear and the feasibility of bill-and-keep for any LECs is better understood.

Third, it is clear that the assumptions underlying COBAK and BASICS are far different from the characteristics of the areas served by small LECs. Assumptions that exchanges are of comparable size and that the local network costs are comparable are incorrect when applied to small rural LECs. It is doubtful that the benefits of COBAK and BASICS can be achieved when such local network costs (and the costs incurred by calling and called parties) are so different.

Fourth, the Commission currently lacks statutory authority to fully implement a unified bill-and-keep approach to intercarrier compensation. Imposing such an approach would impinge the jurisdiction of State commissions to determine reciprocal compensation between competing and incumbent LECs, and between LECs and interexchange carriers (“IXCs”) for intrastate services. Further, Congress’ mandate to preserve and advance universal service is also threatened by an approach to intercarrier compensation that would ignore the universal service impacts on customers of small LECs.

Finally, it is clear that any new system of intercarrier compensation, including bill-and-keep, will inevitably result in new and unintended opportunities for arbitrage and uneconomic incentives. These should be weighed against the claimed benefits of bill-and-keep.

For all of these reasons, the Commission should defer consideration of such a sweeping change as applied to small LECs.

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INTRODUCTION

The following Initial Comments are submitted by the Minnesota Independent Coalition (“MIC”) in response to the Notice of Proposed Rulemaking in this proceeding.¹ The members of the MIC are approximately 80 rural telephone companies² providing local exchange service in Minnesota.

A rulemaking to consider a radical overhaul of intercarrier compensation for small Local Exchange Carriers (“small LECs”) is premature. Instead, the Commission should resolve the pending proceedings concerning rate of return regulated LECs³ and separations reform. Further, if the Commission decides to proceed to investigate the feasibility of a unified bill-and-keep approach, it should exclude small LECs from that investigation because of the substantial differences between small LECs and large price cap LECs in terms of: 1) the impacts on local rates of a shift to bill-and-keep; and 2) the significance of the different characteristics of the

¹ Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92, *Notice of Proposed Rulemaking* FCC 01-132 (rel. April 27, 2001) (“NPRM”).

² 47 U.S.C. § 153(37).

³ In the Matter of Matter of Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, CC Docket Nos. 00-256, 96-45, 98-77, 98-166, *Notice of Proposed Rulemaking*, released January 5, 2001 (the “MAG Rulemaking”).

networks and costs of price cap LECs and small rural LECs and the importance of those characteristics to the assumptions underlying both the COBAK⁴ and BASICS⁵ proposals.

The Commission has previously recognized that the substantial differences between small rural LECs and large price cap LECs require different approaches, separate investigations and a different pace for both access charge reform and universal service reform. The differences between small rural LECs and price cap LECs are just as significant in regards to both the feasibility and consequences of imposing a unified bill-and-keep regime.

1. Adopting Bill-and-Keep Would Lead to Severe Increases to Either Local Rates for Customers of Small LECs or Funding Requirements For State and Federal USF.

Adoption of either the COBAK or BASICS Proposals would transfer to end user customers responsibility for virtually all of the costs of local network facilities, including the vast majority paid through access charge revenues now received by all LECs. For many rural LECs, the sum of interstate and intrastate access revenues represents well over 50% of their total revenues. Transferring such substantial proportions of cost recovery to local rates will inevitably lead to very significant increases. As a result, imposing bill-and-keep would lead to increases in rates for customers of small rural LECs that would be far greater than the local rate increases for customers of price cap LECs.

There are only two sources for recovery of such shifts of cost recovery: 1) local rates can increase; or 2) the cost of the universal service programs can increase. As a result, it will be essential for the Commission to carefully determine the scope of the impact on both local rates and the size of the State and Federal USF funds. This inevitable effect of bill-and-keep would

⁴ Patrick DeGraba, *Bill and Keep at the Central Office As the Efficient Interconnection Regime* (Federal Communications Commission, OPP Working Paper No. 33, Dec. 2000) ("COBAK").

raise additional difficult issues of implementation for both the States and small rural LECs that are not present for larger price cap LECs. The difficulty of these issues alone indicates that the Commission should not proceed with a bill-and-keep investigation for rural LECs until it has conducted an investigation with respect to the implementation of bill-and-keep for larger price cap LECs. The differences between the assumptions underlying COBAK and BASICS and the economic characteristics of providing service in rural areas, which are discussed below, also raise substantial additional questions regarding whether bill-and-keep could be reasonably applied to rural LECs at all.

Further, the elimination of universal service as a significant consideration in determining intercarrier compensation is a key premise of BASICS,⁶ and COBAK focuses primarily on efficiency as the primary criteria.⁷ Given the very severe impact on the local rates of small rural LECs that would result from bill-and-keep, the Commission cannot ignore the universal service implications of intercarrier compensation for small LECs and fulfill its obligations under Section 254.⁸ Although the issues involving intercarrier compensation are extremely difficult and the incentive to make simplifying assumptions is strong, the Commission ultimately remains responsible to develop strategies that successfully address competition, efficiency and universal service. Fulfilling these obligations will be facilitated by deferring consideration of bill-and-keep for small LECs unless and until it has been tested for large price cap LECs.

⁵ Jay M. Atkinson and Christopher C. Barnekov, *A Competitively Neutral Approach to Network Interconnection* (Federal Communications Commission, OPP Working Paper No. 34, Dec. 2000) (“BASICS”).

⁶ BASICS at ¶ 5, 6, 7.

⁷ COBAK at ¶ 47, 48.

⁸ 47 U.S.C. § 254.

2. Considering Bill-and-Keep For Small LECs Will Impose Significant Costs and Uncertainties That Should Not Be Incurred Until Legal Authority and Feasibility Are Clear.

The process of considering bill-and-keep for small LECs will impose significant administrative costs and disincentives to investment by small LECs. These costs and that chilling effect on investments should not be incurred unless and until it is clear that: 1) the Commission has the legal authority to proceed; and 2) bill-and-keep is feasible for at least the large price cap LECs.

The administrative costs of developing and implementing a radical change in intercarrier compensation are enormous. The effort that went into development of the access charge system plus the effort that went into development of the reciprocal compensation system provide some insight into the scope of such an undertaking, since bill-and-keep is intended to replace both.

As significant as those costs may be, the effects of years of uncertainty on the willingness of small LECs to invest in facilities needed to maintain current services and to enable advanced services may be even more significant. The industry closely observes the actions of the Commission, and such actions are a significant factor in the willingness of service providers to make long-term investments. Instability operates as a significant deterrent to investment, particularly when a very large portion of total revenues could be affected. The instability for small LECs that would result from considering a radical change to intercarrier compensation is heightened by the fact that access reform for rate-of-return LECs also remains pending.

Administrative costs and adverse economic impacts of this magnitude should not be incurred unless and until the legal authority to proceed is clear and the basic feasibility of bill-and-keep is demonstrated, at least for large price cap LECs.

3. The Premises and Assumptions Underlying Bill-and-Keep Proposals Do Not Conform To Areas Served By Small Rural LECs.

Both the BASICS and COBAK proposals for bill-and-keep rest on an assumptions that are clearly inaccurate as applied to small, high cost exchanges of rural LECs.

BASICS rests on assumptions that are clearly incorrect as applied to small LECs. These assumptions include: 1) that all networks have the same scale economies;⁹ 2) that all networks have the same average number of subscribers per central office;¹⁰ and 3) that any departures from its size assumptions do not alter the analysis.¹¹ However, it is obvious that rural LECs do not have available the same economies of scale as large price cap LECs and that the average number of customers per central office is much lower in rural areas served by small LECs. These factors indicate that the premises of BASICS are absent for small rural LECs. Further, there is no support for the assumption that size differences do not change the analysis for small exchange areas.¹²

COBAK rests on assumptions that are equally unsound as applied to small rural LECs. These assumptions include: 1) that the originating and terminating networks have equal costs;¹³ 2) that having each customer pay all costs of its local network leads to equal sharing of costs;¹⁴ 3) that increases in local rates from reductions in access charges will lead to corresponding decreases in toll rates;¹⁵ and 4) that increases in rates experienced by customers in high cost areas

⁹ BASICS at ¶ 57.

¹⁰ Id. at ¶ 60, 63

¹¹ Id. at ¶ 64.

¹² Id. “The analysis becomes much more complex, but we believe the essential results would not change. We do not, however, attempt to prove this assertion formally in this paper.”

¹³ COBAK ¶ 55.

¹⁴ Id. at ¶ 64.

¹⁵ Id. at ¶ 125.

will be “slight”.¹⁶ Costs in rural areas served by rural LECs are much higher than the average costs of price cap LECs, and requiring customers of rural LECs to pay all of the costs of their local networks will not lead to an equal sharing of costs. Rate increases incurred by customers in high cost areas may well be severe, particularly if total federal high cost support is capped. Further, it is very doubtful that IXC’s will decrease rates for services available in rural areas by enough to significantly offset the local rate increase that would result.

The realities of the rural areas served by rural LECs such as the MIC Members are very different from the assumptions underlying COBAK and BASICS and cast substantial doubt that imposing bill-and-keep on small LECs serving rural areas would lead to the benefits claimed for bill-and-keep. The Commission should not take steps that would impose significant costs and chill investments in rural areas in the face of such contradictions between the premises of bill-and-keep and the realities of rural areas served by small LECs.

4. A Rulemaking Proceeding Is Premature Because the Commission Lacks Statutory Authority To Adopt Bill-and-Keep.

A rulemaking relating to bill-and-keep for small LECs is premature because the Commission currently lacks statutory authority to implement that system. Imposing bill-and-keep would, as a practical matter, impinge the jurisdiction of the States with respect to intercarrier compensation for intrastate interexchange calling. Further, bill-and-keep appears to be inconsistent with the primary directive of Section 251(b)(5) to establish reciprocal compensation for the exchange of local traffic. Because of the severe adverse impact on local rates for customers of small LECs, bill-and-keep would also conflict with the direction and policy of Section 254 regarding universal service.

¹⁶ Id.

Bill-and-keep would, as a practical matter, impinge the reserved jurisdiction of the States under Section 152 with respect to access charges for intrastate interexchange calling.¹⁷ While it would be possible to implement bill-and-keep to replace interstate access charges without *explicitly* requiring a similar regime for intrastate access charges, maintaining very different compensation requirements for interstate and intrastate long distance services would not be feasible in practice. Attempting to operate such different regimes would be extremely burdensome and would provide very strong incentives to misreport intrastate traffic as interstate in order to avoid intrastate access charges. Such a result is at odds with the core rationale of bill-and-keep, to minimize arbitrage opportunities and incentives.

Bill-and-keep would also reverse the approach to reciprocal compensation under Section 251 that has been very extensively developed.¹⁸ The outright reversal of a very consistent and extensive application of Section 251 should not be undertaken without a statutory amendment. Further, mandating bill-and-keep in lieu of reciprocal compensation may also impinge the authority of the States under Section 252(c). Adoption of the unified intercarrier bill-and-keep proposal would effectively preclude State commissions from making *any* determinations for pricing, and instead impose upon them (and carriers) a single, uniform approach that would be

¹⁷ 47 U.S.C. § 152(b) preserves the jurisdiction of the States and provides, in relevant part:

...nothing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier...

¹⁸ 47 C.F.R. 54.701 et seq.

applied without regards to local conditions. This would eliminate the flexibility that had been deliberately reserved to the States¹⁹ and is inconsistent with the States' role under Section 252.²⁰

In addition, the "preservation and advancement of universal service"²¹ remains a key element in determination of telecommunications and information services policy. In contrast, the express intent of at least one of the bill-and-keep proposals would be to eliminate universal service considerations from intercarrier compensation decisions.²² Adopting such an approach for small rural LECs would be likely to impair universal service because of the dramatic impacts on local rates that would result from bill-and-keep.

5. New and Unintended Consequences Will Inevitably Arise from the Adoption of a Bill-and-Keep Approach to Intercarrier Compensation.

Both COBAK and BASICS assert that adoption of a bill-and-keep approach to intercarrier compensation will eliminate arbitrage opportunities and uneconomic incentives that have arisen from previous Commission decisions regarding intercarrier compensation.²³ However, it is virtually inevitable that adopting a new intercarrier compensation mechanism will lead to yet unexpected arbitrage opportunities and uneconomic incentives.

Unintended consequences are a virtually inevitable result of any significant decision and certainly any regulatory decision because change in the marketplace and technological environment is also inevitable. Certainly, when the decisions were made to adopt the current

¹⁹ In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order, 11 FCC Rcd. 15499, ¶ 114 ("[S]tates will retain the flexibility to consider local technological, environmental, regulatory, and economic conditions.")

²⁰ AT&T Corp. v. Iowa Utilities Board, 525 US 366, 384 (1999) ("It is the States that will apply those [pricing] standards and implement that methodology, determining the concrete result in particular circumstances. That is enough to constitute the establishment of rates [under Section 252(c)].")

²¹ 47 U.S.C. § 254(b).

²² BASICS ¶ 6.

²³ COBAK ¶¶ 80-101; BASICS ¶¶ 75-85.

access charge and reciprocal compensation mechanisms, the Commission and Congress did not, and could not, anticipate all of the changes that have subsequently occurred. The same will prove true with respect to decisions that may be made now. The Commission recognizes this fact.²⁴

Review of COBAK and BASICS shows that arbitrage opportunities and uneconomic incentives will occur even without significant market and technological changes because both COBAK and BASICS substitute new regulatory distinctions for existing distinctions, and arbitrage and uneconomic incentives arise whenever such distinctions are drawn.

For example, COBAK recognizes that, “[w]herever networks interconnect, each network has an incentive to shift the cost of transporting calls to the other network.”²⁵ COBAK also recognizes that there is an incentive for competing LECs to minimize the number of central offices, forcing other LECs to bear the cost of transport to distant “central offices.”²⁶ However, COBAK would also require all LECs to deliver their traffic to the POPs of IXC providers providing service without charges.²⁷ Certainly, this feature would provide a powerful incentive for IXCs to minimize the number of POPs within their networks, increasing the transport distance and the cost that must be borne by the LECs. This incentive is the direct result of the new regulatory distinction proposed under COBAK and provides an example of the unexpected consequences that will result from any new approach to intercarrier compensation.

BASICS proposes a compensation system in which the originating and terminating LECs are responsible for all costs of their own networks and for dividing the incremental of

²⁴ NPRM ¶¶ 58-65.

²⁵ COBAK ¶ 68.

²⁶ COBAK ¶¶ 109-112.

²⁷ COBAK ¶ 26.

interconnection between their networks.²⁸ BASICS appears to contemplate that the same approach would be applied to both LEC to LEC interconnections and to LEC to IXC interconnections.²⁹ However, that topic is not directly addressed in detail, and it is difficult to see how this approach can be applied to a connection between a LEC and an IXC or how this approach can be reconciled to an ongoing retail role for IXCs.

Unintended consequences are inevitable and the risks resulting from unintended consequences lend further support to the deferring consideration of bill-and-keep for small LECs until the application to larger LECs has been more fully explored.

7. Conclusion.

For the reasons set forth above, the Commission should defer any consideration of bill-and-keep for small rural LECs.

Dated: August 21, 2001.

Respectfully submitted,

MOSS & BARNETT
A Professional Association

/s/ Richard J. Johnson

Richard J. Johnson
M. Cecilia Ray
Moss & Barnett
4800 Wells Fargo Center
90 South 7th Street
Minneapolis, MN 55402
612.347.0300

²⁸ BASICS ¶¶ 39, 40.

²⁹ Id. at ¶ 71.

CERTIFICATE OF SERVICE

I, Kim R. Manney, do hereby certify that, on this 21st day of August, 2001, I have caused the foregoing "Initial Comments of Minnesota Independent Coalition" in CC Docket No. 01-92 to be filed electronically with the FCC by using its Electronic Comment Filing System, and copies of the Initial Comments were served by first-class U.S. mail, postage prepaid, on the following parties:

Magalie Roman Salas
Office of the Secretary
Federal Communications Commission
445 12th Street S.W., Room TW-B204
Washington, DC 20554

Paul Moon
Common Carrier Bureau
445 12th Street S.W., Room 3-C423
Washington, DC 20554

Jane Jackson
Common Carrier Bureau
445 12th Street S.W., Room 5-A225
Washington, DC 20554

International Transcription Service, Inc.
445 12th Street S.W., Room CY-B402
Washington, DC 20554

/s/ Kim R. Manney

Kim R. Manney